

Message Text

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PAGE 01 MANILA 18881 01 OF 02 060802Z

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ACTION TRSE-00

INFO OCT-01 EA-07 NEA-10 ISO-00 IO-13 AID-05 CIAE-00

COME-00 EB-07 FRB-03 INR-07 NSAE-00 USIA-06 XMB-02

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P 060628Z DEC 76

FM AMEMBASSY MANILA

TO SECSTATE WASHDC PRIORITY 3559

INFO AMEMBASSY COLOMBO PRIORITY

LIMITED OFFICIAL USE SECTION 1 OF 2 MANILA 18881

USADB

FOR NAC AGENCIES

E.O. 11652: ADS, DECLAS 3/6/77

TAGS: EAID, EFIN, CE

SUBJECT: PROPOSED ADB LOAN AND TECHNICAL ASSISTANCE GRANT FOR
DEVELOPMENT FINANCE CORPORATION OF CEYLON PROJECT

SUMMARY: ADB MANAGEMENT PROPOSES \$5.0 MILLION EQUIVALENT
LOAN FROM SPECIAL FUNDS RESOURCES AND \$75,000 TECHNICAL
ASSISTANCE (TA) GRANT TO GOVT. OF SRI LANKA TO AUGMENT
FOREX RESOURCES OF DEVELOPMENT FINANCE CORP. OF CEYLON
(DFCC) FOR MAKING SUBLOANS TO PRIVATE ENTERPRISES IN THE
INDUSTRIAL SECTOR AND IN AGRICULTURE-RELATED OPERATIONS,
AND TO PROVIDE THE SERVICES OF AN EXPERT ON SMALL-SCALE
INDUSTRIES FOR A PERIOD OF NINE MONTHS. USADB RECOMMENDS
FAVORABLE NAC ACTION. END SUMMARY.

1. ADB DOC. R126-76 WITH ATTACHMENTS DESCRIBING PROPOSED
LOAN AND GRANT POUCHED ADDRESSEES DECEMBER 1. BOARD CON-
SIDERATION SCHEDULED FOR DECEMBER 21.

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PAGE 02 MANILA 18881 01 OF 02 060802Z

2. ADB MANAGEMENT PROPOSING \$5.0 MILLION LOAN FROM

SPECIAL FUNDS RESOURCES AND \$75,000 TA GRANT TO GOVT. OF SRI LANKA (GSL). PROCEEDS OF LOAN WILL AUGMENT FOREX RESOURCES OF DFCC FOR MAKING SUBLOANS TO PRIVATE ENTERPRISES (INCLUDING SMALL-SCALE ENTERPRISES) IN THE INDUSTRIAL SECTOR AND IN AGRICULTURE-RELATED OPERATIONS DURING TWO FISCAL YEARS ENDING MARCH 1979. PROPOSED TERMS ARE 40 YEAR AMORTIZATION, 10 YEAR GRACE PERIOD, 1 PERCENT SERVICE CHARGE. GSL TO BE BORROWER. PROCEEDS WOULD BE RELENT TO DFCC WITH REPAYMENT TO GSL WITHIN 15 YEARS INCLUDING 3 YEAR GRACE PERIOD. REPAYMENT TO BE SYNCHRONIZED WITH REPAYMENT TERMS OF SUBLOANS GRANTED UNDER BANK LOAN. IBRD IS CONSIDERING AN IDA LOAN UP TO \$10 MILLION TO HELP MEET BALANCE OF DFCC'S FOREIGN CURRENCY REQUIREMENTS DURING SAME PERIOD.) PROCEEDS OF GRANT WOULD PROVIDE SERVICES OF CONSULTANT FOR PERIOD OF NINE MONTHS TO IMPROVE DFCC'S OPERATIONS IN FIELD OF SMALL-SCALE INDUSTRIES AS WELL AS OPERATION OF GOVT'S SPECIAL CREDIT SCHEME FOR SMALL-SCALE INDUSTRIES.

3. SRI LANKA ECONOMY REGISTERED GNP GROWTH RATE OF 3.6 PERCENT IN 1975, marginally above the 3.0 to 3.5 percent growth rates of recent years. AGRICULTURAL OUTPUT, INFLUENCED BY 28 PERCENT DECLINE IN PADDY PRODUCTION, FELL BY 2.8 PERCENT IN 1975. INDUSTRIAL PRODUCTION, ON OTHER HAND, ROSE BY 15.5 PERCENT REFLECTING SHARPLY HIGHER RATE OF CAPACITY UTILIZATION. IMPROVEMENT IN INDUSTRY, WHICH HAS CONTINUED IN 1976, WAS RECORDED ALMOST ENTIRELY IN PRIVATE SECTOR FOLLOWING INTRODUCTION OF TAX AND OTHER INVESTMENT INCENTIVES BY GOVT.

4. BALANCE OF TRADE HAS REMAINED HEAVILY IN DEFICIT OWING TO SLUGGISH EXPORTS AND SHARPLY RISING IMPORTS, AGGRAVATED RECENTLY BY OIL PRICE INCREASES AND, IN 1975, BY NEED FOR LARGE-SCALE FOODGRAIN IMPORTS. CURRENT ACCOUNT DEFICIT EXPECTED TO REACH \$245 MILLION IN 1976, NOT INCLUDING \$194 MILLION OF DEBT SERVICE OBLIGATIONS (20.3 PERCENT OF EXPORT EARNINGS). IN SPITE OF INCREASING FOREIGN AID INFLOWS, FOREX FOR IMPORTS HAS HAD TO BE TIGHTLY RATIONED. FOREX RESERVES LIMITED OFFICIAL USE
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PAGE 03 MANILA 18881 01 OF 02 060802Z

AT END-1975 WERE EQUIVALENT OF ONLY 0.9 MONTHS IMPORTS.

5. PRIORITY IN GOVT'S FOREX ALLOCATION IS ACCORDED EXPORT-ORIENTED INDUSTRIES, AS OPPOSED TO EMPHASIS ON IMPORT-SUBSTITUTION THAT PREVAILED DURING 1960'S. HEAVY EMPHASIS ALSO PLACED ON INDUSTRIES THAT CREATE EMPLOYMENT AND ON ACHIEVING BETTER REGIONAL BALANCE IN INDUSTRY. PURSUANT TO THESE OBJECTIVES, GOVT. INTENDS ACTIVELY TO PROMOTE GROWTH OF SMALL-SCALE INDUSTRY.

6. DFCC WAS ESTABLISHED IN 1955 BY ACT OF PARLIAMENT WITH IBRD ADVICE AND ASSISTANCE, FOR PURPOSE OF ASSISTING PRIVATE INDUSTRIAL AND AGRIVULTURAL ENTERPRISES IN SRI LANKA. ASSISTANCE TO COMMRCIAL ENTERPRISES SUCH AS HOTELS, TRANSPORTATION, ETC., PERMITTED AS OF 1967. DFCC IS BY FAR MOST IMPORTANT CREDIT INSTITUTION PROVIDING CREDIT FOR PRIVATE INDUSTRY AND ONLY INSTITUTION WHICH CAN PROVIDE FOREIGN CURRENCY FUNDS FOR MACHINERY AND EQUIPMENT IMPORTS TO PRIVATE SECTOR. PAID-UP CAPITAL AS OF JULY 1, 1976 WAS RS. 8 MILLION (U.S. \$1 EQUALS RS. 14.32, FEEC RATE) OF WHICH 44.9 PERCENT WAS PRIVATELY HELD, 29.6 PERCENT FOREIGN HELD, 25.5 PERCENT HELD BY GOVT. AND GOVT. ORGANIZATIONS. DFCC EXPECTS TO DOUBLE ITS PAID-UP CAPITAL BY MARCH 1980. FIRM PLAN AND TIME-TABLE FOR INCREASE ARE CONDITION FOR EFFECTIVENESS OF PROPOSED LOAN.

7. LEVEL OF OPERATIONS OF DFCC HAS FLUCTUATED WIDELY, PRIMARILY DUE TO CHANGES IN THE INVESTMENT CLIMATE AND AVAILABILITY OF FOREIGN CURRENCY FUNDS. IBRD EXTENDED CREDIT LINES TOTTALLING \$12 MILLION IN 1968 AND 1970, AND IDA ADVANCED \$4.5 MILLION CREDIT IN 1975. OF THE IBRD CREDITS, \$6.9 MILLION WERE CANCELLED IN 1971 OWING TO SLOW UTILIZATION IN DETERIORATING INVESTMENT CLAIMATE OF THAT TIME. DFCC LOAN AND INVESTMENT APPROVALS WHICH HAD REACHED RS. 34 MILLION IN 1969/70, FELL TO RS. 1.0 MILLION, NET, IN 1971/72. OPERATIONS RECOVERED TO AREA OF RS. 20 MILLION IN FOLLOWING TWO YEARS, DECLINED OWING TO SHORTAGE OF FOREIGN CURRENCY TO RS. 8.8 MILLION IN 1974/75, THEN REBOUNDED TO PEAK OF RS. 57.6 MILLION IN 1975/76. APART FROM IDA LOAN, DFCC'S RAPID RECENT LIMITED OFFICIAL USE LIMITED OFFICIAL USE

PAGE 04 MANILA 18881 01 OF 02 060802Z

GROWTH ATTRIBUTABLE TO IMPROVED INVESTMENT CLIMATE AND TO INCREASING SHARE OF EQUITY INVESTMENTS IN OVERALL DFCC OPERATIONS. LATTER ACCOUNTED FOR 27 PERCENT OF TOTAL DFCC APPROVALS IN 1975/76.

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PAGE 01 MANILA 18881 02 OF 02 060812Z

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P 060628Z DEC 76

FM AMEMBASSY MANILA

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LIMITED OFFICIAL USE SECTION 2 OF 2 MANILA 18881

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FOR NAC AGENCIES

8. DFCC'S PORTFOLIO AS OF JUNE 30, 1976 CONSISTED OF RS. 82.4 MILLION IN LOANS, RS. 12.1 MILLION IN SHARE INVESTMENTS. TOURISM SECTOR, I.E. HOTELS AND RELATED INVESTMENTS, ACCOUNTED FOR 35 PERCENT OF TOTAL PORTFOLIO, MANUFACTURING 63 PERCENT. WITHIN MANUFACTURING SECTOR, LEADING SHARES WERE: TEXTILES, 15 PERCENT; ENGINEERING, ELECTRICAL, AND METAL PRODUCTS, 14 PERCENT; FOOD AND BEVERAGES, ABOUT 10 PERCENT. MAJORITY OF LOANS AND INVESTMENTS WERE FOR TERM OF 10 TO 11 YEARS (NOT INCLUDING GRACE PERIOD); ONLY 1 PERCENT FOR LESS THAN 5 YEARS.

9. BULK OF DFCC ASSISTANCE HAS BEEN TO MEDIUM AND LARGE-SCALE FIRMS. DURING PERIOD 1972/73 - MARCH 1976, SMALL-SCALE ENTERPRISES, I.E., THOSE WITH PLANT AND MACHINERY VALUE OF RS. 9.5 MILLION OR LESS, RECEIVED ONLY 0.4 PERCENT OF TOTAL ASSISTANCE APPROVED. TO STIMULATE SUCH ASSISTANCE, IDA EARMARKED \$200,000 OF ITS 1975 LOAN FOR LENDING TO LIMITED OFFICIAL USE
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PAGE 02 MANILA 18881 02 OF 02 060812Z

SMALL-SCALE INDUSTRY. IN JULY 1976 DFCC JOINED A SPECIAL CREDIT SCHEME UNDER WHICH DFCC, THE INDUSTRIAL DEVELOPMENT BOARD (IDB), THE PEOPLE'S BANK, AND BANK OF CEYLON OPERATE JOINTLY TO ASSIST SMALL-SCALE FIRMS WITH FOREIGN CURRENCY LOANS FOR APPROVED INVESTMENT PROJECTS. AT PRESENT, APPLICATIONS FROM SMALL-SCALE FIRMS FOR FOREIGN CURRENCY LOANS MUST BE APPROVED BY BOTH THE BORROWER'S COMMERCIAL BANK AND DFCC, A PROCEDURE THAT COULD PROVE UNDULY CUMBERSOME. FORMALIZATION OF SPECIAL CREDIT

SCHEME IS TO BE CONDITION OF EFFECTIVENESS OF PROPOSED LOAN.

10. EXCEPT FOR THE AREA OF SMALL-SCALE INDUSTRY WHICH IS OBJECT OF PROPOSED TA, DFCC STAFF IS BELIEVED GENERALLY WELL-QUALIFIED AND COMPETENT. AREAS OF PROJECT IMPLEMENTATION AND PROJECT EVALUATION ARE UNDERSTAFFED, BUT DFCC IS TAKING APPROPRIATE STEPS TO RECRUIT ADDITIONAL PERSONNEL.

11. AS OF MARCH 31, 1976 LOANS IN ARREARS TOTALLED RS. 1.0 MILLION, EQUIVALENT TO 1.7 PERCENT OF LOANS IN REPAYMENT STAGE, LESS THAN 1.2 PERCENT OF LOANS OUTSTANDING. ONLY RS.0.2 MILLION OF LOANS ARE CONSIDERED BAD, MORE THAN COVERED BY ACCUMULATED PROVISION FOR DOUBTFUL ACCOUNTS OF RS. 2.1 MILLION. DEBT/EQUITY RATIO ON MARCH 31, 1976 WAS 5.6:1, WELL WITH 7:1 LIMIT SET BY IDA LOAN AGREEMENT, UNDER WHICH EQUITY INCLUDES ONLY PAID-UP CAPITAL AND FREE RESERVES AND TREATING SUBORDINATED GOVT. LOAN OF RS. 16 MILLION AS DEBT.

12. IN ACCORDANCE WITH GOVT'S INVESTMENT STRATEGY, DFCC INTENDS IN FUTURE OPERATIONS TO EMPHASIZE FINANCING OF PROJECTS IN EXPORT-ORIENTED INDUSTRIES, AGRO-BASED INDUSTRIES, AND INDUSTRIES USING LARGELY LOCAL RAW MATERIALS. TOURISM WILL BE DEEMPHASIZED AND NONE OF PROCEEDS OF BANK LOAN WILL BE USED FOR FINANCING TOURISM SECTOR. A MINIMUM OF 10 PERCENT OF PROPOSED LOAN IS TO BE USED FOR FINANCING OF SMALL-SCALE INDUSTRIES.

13. DFCC PROJECTS FOREIGN CURRENCY REQUIREMENT AT \$20.8 MILLION FOR FISCAL YEARS 1976/77 TO 1978-79.
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PAGE 03 MANILA 18881 02 OF 02 060812Z

BALANCE OF IDA CREDIT, WHICH EXPECTED BY FULLY USED BY NOVEMBER 1976, WOULD ACCOUNT FOR \$1.2 MILLION OF THIS; PROPOSED BANK LOAN FOR \$5 MILLION; IBRD LOAN, NOW UNDER CONSIDERATION, FOR \$10 MILLION; AND OTHER SOURCES SUCH AS KFW, CIDA, IFC FOR THE REMAINDER. LOCAL CURRENCY REQUIREMENTS FOR SAME THREE YEARS, PROJECTED AT RS. 53.2 MILLION, WILL BE MET FROM CAPITAL INCREASE OF RS. 8 MILLION, LOAN REPAYMENT, CENTRAL BANK OF CEYLON REFINANCING FACILITY, AND LOCAL BANK BORROWINGS.

14. GOVT. WILL MAKE ADEQUATE PROVISION TO PROTECT DFCC FROM FOREX RISK. GOVT. WILL RELEND TO DFCC AT BANK'S ORDINARY LENDING RATE, NAMELY 8.9 PERCENT. DFCC SUB-LOANS FROM BANK FUNDS WILL BEAR INTEREST SUFFICIENT TO PROVIDE AVERAGE 3.75 PERCENT SPREAD. THIS PROVISION CONSISTENT WITH CURRENT DFCC INTEREST RATE PATTERN OR FOREIGN CURRENCY LOANS, E.E., 12.5 PERCENT FOR LIMITED

COMPANIES, 15 PERCENT FOR OTHER NON-BANK BORROWERS, 10 PERCENT FOR COMMERCIAL BANKS FOR RELENDING UNDER SPECIAL CREDIT SCHEME FOR SMALL-SCALE INDUSTRIES (PARA.9).

15. PRIOR APPROVAL OF BANK TO BE REQUIRED OF FIRST TEN SUBLOANS ABOVE \$100,000; THEREAFTER, ALL OVER \$200,000. I ADDITION, FIRST TEN SUBLOANS TO SMALL-SCALE INDUSTRIES, REGARDLESS OF SIZE, WILL BE SUBMITTED FOR BANK APPROVAL. PROCUREMENT BY SUB-BORROWERS TO BE ON BASIS OF "REASONABLE COMPETITION".

16. TA WILL PROVIDE EXPERT FOR NINE MONTH PERIOD TO IMPROVE DFCC'S OPERATIONS IKD FIELD OF SMALL-SCALE INDUSTRIES AS WELL AS THE OPERATION F THE SMALL-INDUSTRIES CREDIT SCHEME (PARA. 9) . GOVT. HAS AGREED TO COVER LOCAL CURRENCY COSTS ESTIMATED AT \$6,000 EQUIVALENT.

17. DFCC IS PLAYING KEY ROLE IN REVIVAL OF PRIVATE INDUSTRY IN SRI LANKA. PROJECTS IN PIPELINE OR PREAPPRAISAL STAGE INDICATE VERY RAPID EXPANSION IN NEXT FEW YEARS. MISSION BELIEVES DFCC SUITABLE DEVELOPMENT FINANCE INSTITUTION FOR PROPOSED LOAN AND TA GRANT. THIS WOULD BE BANK'S FIRST LOAN FOR DEVELOPMENT BANKING IN SRI LANKA. USADB SUPPORTS PROPOSAL AND RECOMMENDS FAVORABLE NAC LIMITED OFFICIAL USE
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PAGE 04 MANILA 18881 02 OF 02 060812Z

ACTION.

18. REQUEST COLOMBO'S COMMENTS FOR NAC AGENCIES, INFO USADB MANILA, PURSUANT TO STATE 119795 DATED JULY 3, 1972.
SULLIVAN

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Message Attributes

Automatic Decaptioning: X
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Copy: SINGLE
Draft Date: 06 DEC 1976
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: izenbei0
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
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Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
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From: MANILA
Handling Restrictions: n/a
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ISecure: 1
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